Profits of Doom

Why the insurance industry is putting its money on global warming.

Dave Gilson
April 18 , 2005

If you want to hear some tough talk about global warming, talk to an insurer. Take this recent statement by Richard Jones, the vice president for engineering of the Hartford Insurance Company. "Climate change is real," said Jones. "To me, proving that earth's climate is changing from human actions—namely global warming—is like statistically 'proving' the pavement exists after you have jumped out a 30-story building. After each floor, your analysis would say, 'so far, so good,' and then, at the pavement, all uncertainty is removed." Jones's alarm over the impending climate catastrophe is not uncommon, even in an industry known for its buttoned-down, by-the-book image. As the cost of droughts, floods, wind storms, and other weather events linked to climate change multiply, insurers have taken a remarkably active role in speaking out about global warming.

For nearly 15 years, some of the world's largest insurance companies have been on the forefront of effort to confront man-made climate change. They've been watching the warning signs for years: as early as 1973, the German company Munich Re identified climate change as a potential problem. By the 1990s, other European insurers such as the Zurich-based insurance giant Swiss Reinsurance were publicly discussing how the science of global warming was borne out not only by the world's changing weather patterns but also by their own corporate ledgers. In November 1990, the general manager for Swiss Re made the case for taking climate change seriously in the trade publication *Business Insurance*. Noting the recent rise in natural catastrophes, he warned, "if the feared climate change is confirmed, it will obviously stretch the insurance industry to is limits." In other words, if global warming ran its predicted course, it could bankrupt the world's insurers.

At first glance, such concerns may seem counterintuitive. After all, *Business Insurance* is not the kind of publication where you'd expect to find a call to arms on global warming. "People typically assume that big industry will come down on other side of the issue, i.e. saying that doing anything to prevent climate change would be bad for business and for the broader economy," explains Evan Mills, a staff scientist at the Lawrence Berkeley National Laboratory and an expert on the insurance industry's response to climate change. Yet while environmentalists may gladly claim actuaries as allies, profits, not politics, are driving insurers' interest in limiting carbon emissions and promoting clean energy. Industry representatives openly concede that their interest in combating global warming is mercenary: climate change is bad for their bottom line.

Though the long-term effects of global warming threaten the future much of the world's economy, the insurance industry is already feeling the pinch. With $3 trillion in yearly revenues, it is three times the size of the oil industry. And unlike the oil industry, which may be able to ride out the fossil-fuel economy for another 50 years, the insurance industry is sensitive to environmental pressures as they happen. Though the industry is not fighting global warming uniformly —most American companies have been slow to get involved—its efforts are getting attention. Insurers are like the financial canary in the coal mine: When they start gasping for breath, it's time to take notice.

If there's one thing insurers do well, it's number crunching, and their numbers on climate change don't look good. The frequency and impact of weather disasters have been steadily climbing during the past century, with a dramatic uptick in the last 50 years. According to data collected by Munich Re, there were less than 200 weather-related disasters in the 1950s, yet over 1,600 in the 1990s. The economic losses caused by such events increased tenfold during the same four-decade period, from $4 billion in the 50's to $40 billion in the '90s. Meanwhile, the insurance industry's responsibility for covering such losses has risen astronomically. During the 1950s, insurance losses due to weather disasters were negligible; by the 1990s, they were up to $9.2 billion a year. As Lloyd's of London chairman Peter Levine told a recent conference of insurers in San Diego, "The real issue for insurers is natural disasters.... [T]he impact of those disasters has been increasing because the climate is changing, which presents some very serious challenges for insurers."

The numbers for the U.S. are similarly disquieting. Between 1985 and 1999, 14 percent of the world's weather catastrophes hit the U.S., causing 58 percent of the world's insurance losses. The Insurance Services Office calculated that a hurricane-sized weather catastrophe hitting a major U.S. city such as Miami could cost insurers $50 billion and would bankrupt more than a third of American insurance companies. Such scenarios aren't entirely hypothetical: Hurricane Andrew, which hit Florida in 1992, cost insurance companies $17 billion, and put several out of business.

These bleak numbers translate into frightening uncertainty for an industry driven by the assumption that unpredictable risks can be mitigated by plugging reliable information into time-tested formulas that spread those risks around. But the increasing chances of property damage and loss of life due to global climate change make it harder for insurers to be certain that they will be able to cover their assumed risks. As legendary investor Warren Buffet explained in 1992, the possibility of global warming means that "catastrophe insurers can't simply extrapolate past experience." More simply put, the insurance industry is like a casino: The odds are usually on its side. But when those odds suddenly change, it faces the unhappy possibility of a long losing streak.

Some companies are trying to hedge their bets by actively looking for solutions to global warming. Working under the auspices of the United Nations Environment Program Insurance Industry Initiative, over 80 insurance companies from 25 countries are encouraging governmental and corporate efforts to stem carbon emissions. However, American companies have been less active than their Canadian, European, and Asian counterparts. The Chubb Group, for example, is not a member of the UNEP initiative and has resisted calls to be more proactive. Last year, the company blocked a shareholder resolution that might have forced it to take a firm stand against global warming. Such recalcitrance may be due to the success of climate change skeptics in stretching out the "debate" over the existence of global warming. Part of the problem, says Evan Mills, is that some American insurers have yet to see global warming as an opportunity to invest in strategies that might reduce their risks and ultimately save them money.

But the big European insurers' insistence that fighting global warming is good for business has, ironically, caused some free-market climate change skeptics to accuse them of trying to make a buck off of global warming. A recent commentary on *TechCentralStation.com* attacked Swiss Re for hyping the costs of weather disasters so that frightened consumers would flock to buy insurance at higher premiums. The author lamented Swiss Re's "sellout" to the environmental movement: "A company using free enterprise to generate profits through an alliance with a movement that has on its agenda the elimination, or at least a profound restructuring, of the system that has allowed the company to prosper."

While their assessment of the insurers' motivations may be off base, the skeptics are right that consumers may wind up paying more for insurance. “As losses rise, so too will premiums,” explains Mills. “We need to remember that, like any industry, insurers need to cover their losses and generate a reasonable profit for their shareholders. With the patterns of extreme weather events becoming more intense and more variable, the actuarial challenge will grow, and this will, in turn, put pressure on prices.” Another risk to consumers is that nervous insurance companies will stop covering property that’s at particular risk for climate-related disasters. This may not seem like a big concern if you don’t live in a seaside village in the South Pacific or Alaska. But if you live somewhere that ever experiences hurricanes, droughts, flooding, windstorms, blizzards, or heat waves, at some point you may find you’re no longer in good hands.

Dave Gilson is research editor of *Mother Jones*.

This article has been made possible by the Foundation for National Progress, the Investigative Fund of Mother Jones, and gifts from generous readers like you.